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NCTA
National Cable & Telecommunications Association

Neal M. Goldberg General Counsel
1724 Massachusetts Ave N.W. Washington, D.C. 20036-1903
Tel: 202.775.3664 Fax: 202.775.3603

August 2, 2002

EX PARTE OR LATE FILED

EX PARTE

DELIVERED BY HAND

W. Kenneth Ferree
Chief, Media Bureau
Federal Communications Commission
445 12th Street, SW, Rm. 3-C740
Washington, DC 20554

Re: Commercial Availability of Navigation Devices (CS Docket No. 97-80)

Dear Mr. Ferree:

On Tuesday, June 4, 2002, representatives of the National Cable & Telecommunications Association ("NCTA") met with Media Bureau staff to discuss the FCC rule prohibiting cable operators from providing to consumers any new set-top boxes with embedded security as of January 1, 2005 (the "integration ban"). Under the FCC rule, after January 1, 2005, cable operators would no longer be able to place in service new set-top boxes that perform both conditional access (*i.e.*, security) and other functions in a single integrated device. Rather they would be required to offer *two* pieces of equipment to all of their customers: (1) a separate security "Point-of-Deployment" module (*i.e.*, a "POD") and (2) a device performing non-security functions that would connect to, and interoperate with, the POD (*i.e.*, a "Host").

At the June 4, 2002 meeting, NCTA explained that it would be in the public interest to eliminate the January 1, 2005 ban on cable operator provision of integrated set-top boxes because, based on the data in the record, the ban would impose significant additional costs on cable consumers without providing any offsetting benefits.[1] We also noted that the Commission's stated rationale for the rule no longer was valid because, among other things, the cable industry's Retail Set-Top Box Initiative allows *the same integrated set-top boxes* that operators lease to their consumers to be made available to customers at retail.

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[1] See Ex Parte Letter from Neal Goldberg, General Counsel, NCTA, to Marlene Dortch, Secretary, FCC, filed in CS Dkt. No. 97-80 (June 4, 2002) ("June 4 Ex Parte").

During the meeting, Media Bureau staff observed that the cost data in the record had been submitted over 20 months ago and asked if we had more recent data. The attached Report provides current cost data which supports the cost-benefit analysis discussed at the June 4, 2002 meeting and reinforces the argument for elimination of the integration ban.

Specifically, the Report demonstrates that the combination of a separate security POD and a Host device ("POD-Host Combination") would cost a cable operator approximately $72 to $93 more that an integrated set-top box with the same functionality. The additional cost to the operator, in turn, translates into a potential increase in monthly regulated consumer equipment lease rates of approximately *$1.99 to $2.98 for each POD-Host Combination deployed in the consumer's home.* Accordingly, on an industry-wide basis, the integration ban's mandate that only POD-Host Combinations may be placed in service after January 1, 2005 threatens to impose billions of dollars of additional and unnecessary costs on consumers.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Neal M. Goldberg

Enclosure

cc: Marlene Dortch, Secretary (for inclusion in CS Docket No. 97-80)
Chairman Michael K. Powell
Commissioner Kathleen Abernathy
Commissioner Michael Copps
Commissioner Kevin Martin
William Johnson, Deputy Chief, Media Bureau
Rick Chessen, Associate Bureau Chief, Media Bureau
Kyle Dixon, Deputy Bureau Chief, Media Bureau
Deborah Klein, Chief of Staff, Media Bureau
Mary Beth Murphy, Chief, Policy Division, Media Bureau
Tom Horan, Legal Advisor to Chief, Media Bureau
Susan Mort, Attorney Advisor, Media Bureau
John Wong, Chief, Engineering Division, Media Bureau
Michael Lance, Deputy Chief, Engineering Division, Media Bureau
Bruce Franca, Deputy Chief, Office of Engineering & Technology
Robert Pepper, Chief, Office of Plans and Policy
Amy Nathan, Senior Legal Counsel, Office of Plans and Policy
Jonathan Levy, Deputy Chief Economist, Office of Plans and Policy

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 304 of the Telecommunications Act of 1996	)	CS Docket No. 97-80
	)	
	)	
Commercial Availability of Navigation Devices	)	

REPORT OF THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION REGARDING THE SIGNIFICANT COSTS TO CONSUMERS ARISING FROM THE 2005 BAN ON INTEGRATED SET-TOP BOXES

Daniel L. Brenner
Neal M. Goldberg
Loretta P. Polk

Counsel for the National Cable & Telecommunications Association
1724 Massachusetts Avenue, N.W.
Washington, D.C. 20036
(202) 775-3664

William A. Check, Ph.D.
Vice President, Science & Technology

Andy Scott
Director of Engineering

August 2, 2002

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 304 of the Telecommunications Act of 1996	)	CS Docket No. 97-80
	)	
	)	
Commercial Availability of Navigation Devices	)	

REPORT OF THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION REGARDING THE SIGNIFICANT COSTS TO CONSUMERS ARISING FROM THE 2005 BAN ON INTEGRATED SET-TOP BOXES

I. INTRODUCTION AND SUMMARY

The National Cable & Telecommunications Association ("NCTA") submits the following report in the above-captioned proceeding, in response to questions raised at a recent *ex parte* meeting between NCTA representatives and Media Bureau staff regarding the Commission's commercial availability rules.[1] At the meeting, NCTA explained that it would be in the public interest to eliminate the January 1, 2005 ban on integrated set-top boxes (the "integration ban") because the ban would impose significant additional costs on cable customers without providing

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[1] *See Ex Parte* Letter from Neal Goldberg, General Counsel, NCTA, to Marlene Dortch, Secretary, FCC, filed in CS Dkt. No. 97-80 (June 4, 2002) ("June 4 *Ex Parte*").

any offsetting benefits.[2] This report, together with the attached declaration, provides further evidence in support of this view.[3]

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[2] Under the integration ban, after January 1, 2005, cable operators would no longer be able to place in service new set-top boxes that perform both conditional access (*i.e.*, security) and other functions in a single integrated device. *See* 47 C.F.R. § 76.1204(a)(1). Rather, they would be required to offer *two* pieces of equipment to all of their customers: (1) a separate security "Point-of-Deployment" module (*i.e.*, a "POD") and (2) a device performing non-security functions that would connect to, and interoperate with, the POD (*i.e.*, a "Host"). Customers could obtain the Host device either from the cable operator or from a retailer or other vendor that decided to sell such devices. CableLabs, the research and development consortium for the cable industry, through its OpenCable initiative, has developed specifications for the POD-Host interface to enable the interconnection and interoperation of the POD and Host. These specifications have been adopted as U.S. standards by the Society of Cable Telecommunications Engineers ("SCTE"), an ANSI-accredited standards-setting organization. Through the efforts of CableLabs, cable operators, and manufacturers, the cable industry met the FCC's July, 2000 deadline to have PODs available for use in Host devices. *See* 47 C.F.R. 76.1204(a) and (e).

[3] As detailed in the prior filings of NCTA and others in this proceeding, there are numerous other reasons why the integration ban does not serve the interests of consumers. *See, e.g.*, NCTA Comments, filed in CS Dkt. No. 97-80, at 30-32 (Nov. 15, 2000) ("NCTA Retail Sale Comments") (integration ban reduces competition, consumer choice, and product innovation); AT&T Comments, filed in CS Dkt. No. 97-80, at 26-27 (Nov. 15, 2000) ("AT&T Retail Sale Comments") (same); NCTA Reply Comments, filed in CS Dkt. No. 97-80, at 26-27 (Dec. 18, 2000) ("NCTA Retail Sale Reply Comments") (same); NCTA *Ex Parte* Response To CERC, filed in CS Dkt. No. 97-80, at 20 (Sept. 21, 2001) ("NCTA Response To CERC") (same); NCTA Petition for Expedited Reconsideration, filed in CS Dkt. No. 97-80, at 22-23 (Aug. 14, 1998) (integration ban prohibits cable operators from continuing to offer embedded security devices, which embody the best means of protecting signal security; "[b]ecause cable signal theft imposes a cost burden not only on cable operators and programmers, but also on innocent subscribers, anything that enhances security consistent with the statute is in the public interest"). *See also* Comments of General Instrument Corporation, filed in CS Docket No. 97-80 (May 16, 1997) at 60, Appendix B ("Primer on Security Methods and Physical Implementation of Security") (providing a technical description of the various types of analog and digital security technologies), Appendix D (GI white paper discussing the technical and security problems with smart card technology and the superiority of embedded security systems).

NCTA's positions on the key issues in the pending commercial availability proceeding, including the elimination of the integration ban, are summarized in the June 4 *Ex Parte* cited above. NCTA herein focuses primarily on providing additional evidence regarding the likely cost impact of the integration ban on consumers.

Specifically, in response to questions raised by the Commission staff, NCTA conducted an inquiry which shows that the combination of a separate security POD and a Host device ("POD-Host Combination") would cost a cable operator approximately $72 to $93 more than an integrated set-top box with the same functionality. The additional cost to the operator, in turn, translates into a potential increase in monthly regulated consumer equipment lease rates of approximately *$1.99 to $2.98 for each POD-Host Combination deployed in the consumer's home*. Accordingly, on an industry-wide basis, the integration ban's mandate that only POD-Host Combinations may be placed in service after January 1, 2005 threatens to impose billions of dollars of additional costs on consumers.

Moreover, circumstances have changed since the Commission first adopted the ban. Most notably, the fact that integrated digital set-top boxes do not present the same theft-of-service threat as analog devices has enabled the cable industry to support the retail sale of integrated set-top boxes identical to those provided by cable operators. This development eliminates the rationale for the ban.

Given the significant additional cost that would be imposed on consumers as a result of the ban, the lack of a demonstrable public interest benefit that could reasonably be cited as outweighing these costs, and the fact that the Commission's prior rationale for the ban no longer exists, NCTA respectfully urges the Commission to eliminate the integration ban.

II. A POD-HOST COMBINATION WILL COST CABLE OPERATORS APPROXIMATELY $72 TO $93 MORE THAN AN INTEGRATED SET-TOP BOX WITH THE SAME FUNCTIONALITY, RESULTING IN A POTENTIAL INCREASE IN MONTHLY SUBSCRIBER EQUIPMENT RATES OF BETWEEN $1.99 AND $2.98 FOR *EACH* POD-HOST COMBINATION.

As NCTA previously has shown, implementation of the integration ban would substantially increase cable subscriber equipment costs and significantly reduce the equipment options available to consumers.[4] Both Chairman Powell and the D.C. Circuit also have previously raised concern that the ban would have this effect. In particular, in discussing the impact of the Commission's decision adopting the ban, Chairman Powell observed that it "is contrary to good public policy to remove from the market a potentially cost-effective choice for consumers."[5] Yet, as Chairman Powell recognized, this is precisely what the ban does.[6] The D.C. Circuit has similarly observed:

> Consumers might [choose] not to purchase retail devices for perfectly sensible economic reasons -- because, for instance, there are efficiency gains captured in the manufacture of an integrated box that lead it to cost less than the combined cost of a separate security module and a retail

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[4] *See* NCTA filings cited in n. 3, *supra*.

[5] *In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, Order on Reconsideration, 14 FCC Rcd. 7596, 7632 (1999) ("*Reconsideration Order*") (Statement of Commissioner Powell).

[6] *See id.* ("It would be more practical to allow operators to deploy integrated boxes that may well be less costly and provide greater security for the system. The benefits of allowing operators to use such equipment would redound to consumers, giving them more equipment options at potentially lower prices.") *See also In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, Report and Order, 13 FCC Rcd. 14775, 14848 (1998) ("*Report and Order*") (Statement of Commissioner Powell) ("I fear that the majority decision today denies a cost effective choice for consumers. It is quite plausible to me that the 'impediment' to switching to retail may in fact be a consumer preference for distributor-supplied boxes! I see no reason to attempt to control consumer preferences.").

> device, or because consumers view as too high the transaction cost of seeking a separate ancillary device at retail.[7]

Comments previously submitted by cable operators and equipment vendors in this proceeding have included cost estimates indicating that a POD-Host Combination is significantly more expensive than an integrated device performing the same functions.[8] In response to questions raised by Media Bureau staff and in light of the fact that the most recent cost estimates currently in the record were submitted over 20 months ago, NCTA submits the following information, which reflect the results of an inquiry and analysis undertaken by NCTA, in an effort to refresh and enhance the record with respect to the cost issue.

The cost information collected by NCTA is based on consultations with Motorola and Scientific-Atlanta, leading manufacturers that are familiar with the POD-Host specifications developed through the OpenCable process, and that have developed POD and Host devices designed to meet those specifications. On the basis of these discussions, NCTA's staff has confirmed that there are a variety of technical and engineering factors contributing to the additional cost of designing and manufacturing a POD-Host Combination, as compared with an integrated set-top device. Specifically, production of a POD-Host Combination requires not only the inclusion of a new interface and physically separate security module that is not needed with integrated devices, but also the design and implementation of complex engineering solutions for *both* sides of this interface as opposed to a *single* set of solutions for an integrated device.

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7 *General Instrument Corp. v. FCC*, 213 F. 3d 724, 731 (D.C. Cir. 2000).

8 *See, e.g.*, AT&T Retail Sale Comments at 19; Motorola Comments, filed in CS Dkt. No. 97-80, at 12-17, 19-20 (Nov. 15, 2000) ("Motorola Retail Sale Comments").

For example, the POD and Host require their own separate central processing units, memory, firmware, and software. In addition, there are new PCMCIA-compliant connectors and physical packaging for the interface and command and signalling protocols that are not required when security and non-security functionality reside in a single integrated unit. Moreover, separate copy protection encryption/decryption functionality in *both* the POD *and* Host is necessary to ensure that encrypted programming is secure as it passes across the POD-Host interface. The cost estimates provided by the manufacturers indicate that, as a result of all of these factors, a POD-Host Combination will cost cable operators approximately $72 to $93 more than an integrated set-top box with the same functionality.[9]

The attached declaration, prepared by Richard D. Treich, Senior Vice President for Rates & Regulatory Matters at AT&T Broadband, details the potential adverse impact which the added costs to cable operators associated with the POD-Host Combination would have on consumers' regulated monthly lease rates for such equipment. Using the mid-point of the above-described range of additional costs (*i.e.*, $82.50),[10] Mr. Treich separately calculates the potential increase in monthly customer lease rates at or near the mid-point of a five-year and three-year depreciation

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[9] The manufacturers' estimates of these additional costs were calculated based on volume purchases of integrated boxes and POD-Host Combinations. Given the dynamics of the marketplace, the actual per unit cost incurred by a cable operator in connection with a particular purchase of integrated boxes or POD-Host Combinations will vary based on the specific nature of the product, the volume purchased, and other factors. The information provided to NCTA by the manufacturers also indicates that, as customer equipment becomes more complex and multi-functional in order to provide new and converging video and non-video services, separating security from the set-top box could result in even greater additional costs to the cable operator for the POD-Host Combination.

[10] The mid-point of the range of additional costs identified above is calculated as follows: ($72 + $93) ÷ 2 = $82.50.

cycle for the POD-Host Combination.[11] Based on these calculations, Mr. Treich concludes that the potential monthly rate increase for consumers would range from approximately $1.99 (in the third year of a five-year depreciation cycle) to $2.98 (in the second year of a three-year depreciation cycle) for *each* POD-Host Combination.[12] Viewed on an industry-wide basis, the integration ban threatens to impose billions of dollars in added costs on consumers.[13]

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[11] More specifically, under the first scenario, Mr. Treich calculates the potential regulated monthly rate increase at the mid-point of a five-year depreciation cycle for the POD-Host Combination (*i.e.*, the beginning of Year 3), and, under the second scenario, at the beginning of Year 2 of a three-year depreciation cycle. Calculations were performed at or near the mid-point of the depreciation cycle and using the mid-point of the additional cost range in order to provide a representative view of the potential increase in monthly lease rates for cable customer equipment. However, as Mr. Treich points out, the potential monthly rate increase for each POD-Host Combination would be somewhat higher in the years *before* the mid-point in the equipment's depreciable life and somewhat lower in the years *after* the mid-point. *See* Appendix A, Declaration of Richard D. Treich, Senior Vice President for Rates & Regulatory Matters, AT&T Broadband at ¶¶ 3 and 4.

[12] *See id.* at ¶¶ 2-4. Thus, a cable subscriber who uses a POD-Host Combination in the living room and two bedrooms would face a potential monthly rate increase of $5.97 to $8.94 per month above what he/she currently pays to lease three integrated digital set-top boxes, while receiving no additional benefit.

[13] There will be approximately 32.1 million integrated digital set-top boxes deployed in cable subscriber homes by the end of 2002. *See* Kagan World Media, *Broadband Technology*, April 12, 2002, at 1. While the ban does not require the immediate replacement of all existing integrated set-top boxes as of January 1, 2005, once these boxes are eventually replaced by POD-Host Combinations as a result of the ban, the total additional wholesale cost of these replacements, which ultimately will be borne by consumers, would be over $2.6 billion (*i.e.*, 32.1 million boxes times $82.50, the mid-point of the range of additional costs for each POD-Host Combination identified above). This figure does not even account for the significant additional cost impact on consumers going forward as *new* POD-Host Combinations are deployed.

III. THE SUBSTANTIAL ADDED COSTS THAT WOULD BE IMPOSED BY THE INTEGRATION BAN FAR OUTWEIGH THE PURPORTED BENEFITS CITED BY PROPONENTS OF THE BAN.

This additional evidence makes it even clearer that the integration ban disserves the very purpose of Section 629, the "commercial availability" provision of the Communications Act. As the D.C. Circuit has recognized, if consumers choose not to purchase Host devices at retail for "perfectly sensible economic reasons," the integration ban "does nothing more than deny the most cost-effective product choice to consumers -- an ironic outcome for an order implementing 'one of the most pro-consumer, pro-competitive provisions of the Telecom Act.'"[14]

Clearly, the Commission should give substantial weight to this significant cost burden as it revisits the appropriateness of retaining the integration ban, particularly when it has specifically invited comment on this very issue.[15] This would be fully consistent with the approach the Commission has taken with respect to cost-benefit assessments in other contexts. For example, in its *Computer III* rulemaking, the Commission eliminated the separate affiliate requirement for telephone companies that provided information services, after weighing the costs and benefits of the rule.[16] In particular, the Commission concluded that "relative to nonstructural safeguards, the structural separation requirements impose significant costs on the public in

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[14] *General Instrument Corp.*, 213 F.3d at 731-32 (quoting statement of Commissioner Ness).

[15] *See In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, Further Notice of Proposed Rulemaking, 15 FCC Rcd. 18199, 18203(¶ 11) (2000) (inviting comment on the "total cost differential . . . between an integrated box and a host/POD combination").

[16] *See Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, Report and Order, 104 FCC 2d. 958, 1002-1012 (¶¶ 78-99) (1986).

decreased efficiency and innovation that substantially outweigh their benefits."[17] Similarly, in the wireless context, the Commission utilized cost-benefit analyses in deciding to exclude paging companies from number portability mandates[18] and in declining to implement the use of 1 or 0 at the beginning of the exchange code.[19] The Chairman and other current members of the Commission also have commented individually on the value of and need for more rigorous cost-benefit analyses in the rulemaking process.[20]

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[17] *Id.* ¶ 3. *See also id.* ¶ 79 (noting that the rule "effectively prohibits the offering of all enhanced services that could be efficiently integrated or collocated [with the phone company's basic services], but cannot be offered on a cost-effective basis subject to structural separation").

[18] *See In the Matter of Telephone Number Portability*, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd. 8352, 8433 (¶ 156 n.451) (1996) ("Because of the technical hurdles faced by paging and other messaging service providers, the minimal impact that paging...[has] on local exchange competition, and the competitive nature of paging...we conclude that the costs to paging companies to upgrade their networks to accommodate either interim or long-term number portability solutions, estimated at $30 million by one carrier, outweigh the competitive benefits derived from service provider portability").

[19] *See In the Matter of Numbering Resource Optimization; Petition for Declaratory Ruling and Request For Expedited Action on the July 15, 1997 Order of the Pennsylvania Public Utility Commission Regarding Area Codes 412, 610, 215, and 717*, Second Report and Order, 16 FCC Rcd. 306, 352-353 (¶ 106) (2000) (concluding that the incremental costs involved outweighed any benefits that would be gained by making more numbers available for use by the public). *See also In the Matter of Amendments to Parts 1, 2, 27 and 90 of the Commission's Rules to License Services in the 216-220 MHz, 1390-1395 MHz, 1427-1429 MHz, 1429-1432 MHz, 1432-1435 MHz, 1670-1675 MHz, and 2385-2390 MHz Government Transfer Bands*, Report and Order, 17 FCC Rcd. 9980, 10032 (¶ 130) (2002) (establishing less stringent out-of-band emission limits for the 2385-2390 MHz band "in consideration of the potential cost or service implications a stricter technical standard would impose on the development of mobile operations in this band"). Likewise, in its pending cable modem service proceeding, the Commission has invited comments on the costs and benefits associated with imposing a multiple ISP requirement on cable operators. *See In the Matter of Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, Notice of Proposed Rulemaking, 17 FCC Rcd. 4798, 4845-4846 (¶¶ 88-91) (2002).

[20] *See, e.g.*, Commissioner Michael Powell, Remarks to the Federal Communications Bar Association, June 15, 1999, Chicago, IL ("[W]e should carefully assess the costs of regulation,

(footnote continued...)

The enormous costs that would be imposed on consumers by the integration ban are particularly troublesome, given that the asserted benefits of the ban are wholly speculative. For example, proponents of the integration ban cite enhanced portability of Host devices as a principal consumer benefit.[21] Yet, the integration ban would force cable operators and *all* cable subscribers to bear the added costs associated with the POD-Host Combination, despite the fact that the enhanced portability of Host devices provides *no* added value to subscribers who choose

(...footnote continued)

including direct costs, indirect costs and opportunity costs. It is not difficult to identify a problem and suggest the answer in terms of a general rule or provision of law. In so doing, however, it is easy to ignore the enormous costs and complexities of trying to actually craft and implement rules that are clear, effective and efficient."); Separate Statement of Commissioner Michael Copps, *In the Matter of Communications Assistance for Law Enforcement Act*, Order on Remand, 17 FCC Rcd. 6896 (2002) (expressing concern that "CALEA-related costs for these government mandates will be high for residential customers and wireless providers, especially for rural providers"); Statement of Commissioner Kathleen Abernathy, Dissenting in Part, *In the Matter of Verizon Petition for Partial Forbearance from the Commercial Mobile Radio Services Number Portability Obligation and Telephone Number Portability*, WT Docket No. 01-184, CC Docket No. 95-116, Memorandum Opinion and Order, FCC No. 02-215 (released July 26, 2002) ("[w]e should resist substituting our judgment for the market's judgment of how best to serve consumers. . . . Today, I find little record support for the conclusion that consumers would readily prefer LNP to better coverage, lower prices, or more innovation services. Capital is a zero sum game; resources spent on this mandate in a competitive market will have an impact on other products and services that benefit consumers, including price, coverage, innovation and other mandates such as E911."); Commissioner Kevin J. Martin, Address to the Media Institute, Dec. 11, 2001, Washington, D.C. ("In the past, the Commission has used prophylactic rules in its application of media ownership restrictions. The costs and benefits of such structural rules, however, need to be re-examined to determine whether prophylactic guidelines ruling media ownership continue to be the best way to preserve the public interest."). Other federal agencies and departments increasingly incorporate cost-benefit analyses in their rulemaking proceedings as well. *See* Rebecca Adams, *Regulating the Rule-Makers: John Graham at OIRA*, 60 CQ Weekly 520, 525 (2002) (describing Administration efforts to require federal departments to conduct cost-benefit analysis in rulemaking proceedings).

[21] *See, e.g.*, Consumer Electronics Retailers Coalition Reply to the NCTA Letter as to "Retail Set-Top Initiative" and to the NCTA Response to CERC Status Report "J2K Plus 1," filed in Docket No. 97-80 (November 6, 2001) at 7 (arguing that additional regulation is required to assure "true national portability" of navigation devices).

to *lease*, rather than purchase, their set-top boxes, because those boxes stay within one operator's cable system.

To the extent that consumers may wish to purchase OpenCable-compliant portable Host devices at retail outlets, the cable industry is fully committed to giving them that option. Leading MSOs have made explicit on a number of occasions over the past several years their commitment to support the interconnection and use of OpenCable-compliant Host devices purchased at retail.[22] Moreover, MSOs also have agreed to encourage their set-top box suppliers to make the same *integrated* set-top boxes they provide to the MSOs available through retail outlets, and have committed to provision and support these boxes in their systems, thereby giving consumers yet another option for obtaining cable customer equipment.[23]

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[22] *See* Letter from major cable MSO executives to Dr. Richard R. Green, President and CEO, CableLabs (Nov. 24, 1999) (confirming MSOs' "complete support" of CableLabs' OpenCable project and commitment to supporting the interoperability of their cable systems with set-top boxes, integrated TV receivers, and other navigation devices which comply with OpenCable specifications). *See also Ex Parte* Letter from William A. Check, Ph.D., Vice President, Science & Technology, National Cable & Telecommunications Association, to Magalie R. Salas, Secretary, Federal Communications Commission, filed in PP Docket No. 00-67 (Dec. 26, 2001), appending December 21, 2001 letter from leading cable MSO executives to Richard R. Green, President and CEO, CableLabs (expressing MSOs' intention to take all reasonable steps to ensure that their cable systems will support CableLabs-certified, OCAP-enabled devices); Letter from William A. Check, Ph.D., Vice President, Science & Technology, NCTA, to Rick Chessen, Associate Bureau Chief, Mass Media Bureau, FCC, filed in PP Docket No. 00-67 (Feb. 28, 2002), appending Letter from MSO members of CableLabs Executive Committee to Dr. Richard R. Green, President and CEO, CableLabs (Jan. 18, 2002) (reaffirming MSOs' commitment to support CableLabs-certified integrated digital television sets, so that such devices can provide access to services that are made available to cable subscribers using MSO-leased set-top boxes). Copies of each of these MSO letters are attached in Appendix B hereto. These letters make it clear that cable operators are fully committed to taking the steps necessary to enable consumers purchasing OpenCable-compliant Host devices at retail to interconnect and use such devices to access operator-provided services.

[23] *See Ex Parte* Letter from Robert Sachs, President and Chief Executive Officer, National Cable & Telecommunications Association to The Honorable Michael K. Powell, Chairman,

(footnote continued...)

In contrast, retaining the integration ban does nothing to enhance consumer choice, but instead will prohibit cable operators from placing any new integrated set-top boxes in service after January 1, 2005, despite the fact that they are a more secure and less expensive option, which may be better suited to meet the individual needs and preferences of certain subscribers. Indeed, by imposing significant additional costs with no offsetting benefit, the ban is likely to have a significant negative impact on the ability and willingness of existing and potential cable subscribers to reap the benefits of innovative new digital cable services. Stated another way, the ban will impair, rather than promote, the DTV transition, which the cable industry has committed to support, in response to Chairman Powell's voluntary DTV transition plan, by taking immediate steps that include: 1) placing orders for integrated high-definition (HD) set-top boxes with digital connectors and making these boxes available for lease by subscribers, and 2) consistent with NCTA's Retail Set-Top Box Initiative, supporting the interconnection and use of integrated HD set-tops purchased at retail outlets.[24]

Nor will retention of the integration ban make it any more likely that retailers will embrace the retail sale of cable set-top boxes. As NCTA has previously demonstrated, to the extent there is an impediment slowing development of a retail marketplace for set-top boxes, it is

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(...footnote continued)

FCC, filed in CS Docket No. 97-80 (October 10, 2001) ("NCTA Retail Set-Top Box Initiative"). A copy of this letter is attached as Appendix C hereto.

[24] *See* Letter from Robert Sachs, President and CEO, NCTA to the Honorable Michael K. Powell, Chairman, FCC (May 1, 2002) at 2 (conveying commitments made by the ten largest cable MSOs in response to Chairman Powell's call for voluntary industry action in specific areas, described in the Chairman's April 4, 2002 proposal to speed the digital television transition, which, among other things, urged the industry to provide cable subscribers the option of leasing or purchasing a single high-definition set-top box that includes digital connectors).

the retailers' desire to pursue a more favorable business model for their sale of navigation devices. More specifically, it appears that the retailers' desire for higher profit margins on set-top boxes -- which they seek to realize by forcing cable operators to assign them a portion of the operators' revenues from cable services provided to subscribers who obtain cable customer equipment at retail -- is at the crux of their unwillingness to commit to the purchase and sale to consumers of OpenCable Host products or integrated set-top devices. Indeed, the record shows that manufacturers who have approached retailers regarding the possible purchase of OpenCable Host boxes repeatedly have been rebuffed by retailers who reportedly were not interested in selling "just boxes."[25] This conclusion is confirmed by numerous press reports describing how retailers "hope to hold out for a share of on-going service revenues" before agreeing to market digital cable boxes.[26]

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[25] *See* Motorola Retail Sale Comments at 9-10.

[26] Monica Hogan, "MSOs Tread Carefully Into Retail World: Retailers Want Piece of the Profits, Too," *Multichannel News*, May 1, 2000, at 121. *See also* "Scientific-Atlanta Readies for Retail of Set-Top Boxes," *The Atlanta Constitution*, June 28, 2000, at E-1, 9 (quoting statement of Wachovia Securities Industry Analyst George Hunt that "[t]he first thing Circuit City wanted was a portion of the monthly cable bill"); "Bickering Delays Retail Debut of Set-Top Cable Boxes," *USA Today*, July 25, 2000, at B-1 (quoting statement by Radio Shack senior executive that "we believe that we deserve a piece of that [cable] revenue stream"); "Pricing Quandary Slows Down Retail Set-Top's Development," *Extra/Extra*, Nov. 30, 2000, at 10 (noting that major consumer electronics retailers "want to follow the DBS and cell phone business model, where the product is subsidized and the retailers get a nice slice of the monthly revenue."); *cf.* Gary Arlen, "Electronics Courtship Doesn't End Competition," *Multichannel News*, Jan. 28, 2002, at 32 ("The growing mantra among electronics makers, and their retail outlets calls for bundling services with the hardware. The Consumer Electronics Association is a major cheerleader for that concept, which gives its constituency an annuity revenue stream. According to this vision, selling the network gateway devices would entitle dealers and vendors to a piece of the monthly subscription action."). *See also* NCTA Retail Sale Comments at 15, 23-25; NCTA Retail Sale Reply Comments at 22-24; NCTA Response To CERC at 8.

Even after the integration ban's January 1, 2005 effective date, retailers presumably will have no greater interest in selling "just boxes" and will continue to refrain from making any commitment to purchase Host devices for resale to consumers until they are given an economic inducement, in the form of higher profit margins, to do so.[27] So, while it is clear that implementing the integration ban will saddle cable customers with the enormous additional costs described above for *each* POD-Host Combination, there is no basis for presuming or predicting that the integration ban will spur the retail sale of Host devices.

IV. IN LIGHT OF CHANGED CIRCUMSTANCES, THE COMMISSION'S RATIONALE FOR THE INTEGRATION BAN NO LONGER EXISTS.

As the discussion above demonstrates, under any reasonable cost-benefit calculus, the inexorable conclusion is that the integration ban should be eliminated. This conclusion is especially justified given that the Commission's rationale for the integration ban is no longer tenable in light of changed circumstances.

The integration ban was adopted based on the assumption that integrated devices would otherwise be available *only* through the cable operator. Indeed, the Commission explicitly justified its decision to impose the ban on the basis that "[a]llowing MVPDs the advantage of being the *only* entity offering bundled boxes [*i.e.*, integrated boxes with embedded security] could adversely affect the development of this equipment market," and that accordingly "the prohibition on integrated boxes allows for equal competition in the marketplace."[28]

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[27] In this regard, it is important to note that the Commission has no authority to require retailers to make any commitment whatsoever, now or in the future, to the retail sale of Host devices.

[28] *Reconsideration Order* ¶ 30. The language and legislative history of Section 629 of the Communications Act make clear that the commercial availability provisions were intended to

(footnote continued...)

However, the fact that integrated digital set-top boxes do not present the same theft-of-service threat as analog devices has enabled the cable industry to support the retail sale of integrated digital set-top boxes identical to those provided by operators,[29] thereby eliminating the rationale for the ban.[30] Since the cable industry has now committed to support *integrated* devices purchased at retail which are *identical to those provided by cable operators themselves*, the Commission's own reasoning suggests that the prohibition can no longer be justified. For this reason as well (in addition to the cost arguments discussed above), the Commission should eliminate the integration ban.

NCTA wishes to be clear. It is not advocating the abandonment of POD-Host. In fact, as noted above, leading MSOs have consistently affirmed the cable industry's ongoing commitment

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(...footnote continued)

ensure that consumers were not *forced* to purchase or lease navigation devices from the MVPD network operator. *See* 47 U.S.C. § 549(a); S.Rpt 104-230, 104th Cong., 2nd Sess. (1996) at 181; *see also General Instrument Corp.*, 213 F.3d at 727 (noting that "[c]onverter boxes traditionally have been available to consumers only by lease from cable operators," and further observing that pursuant to Section 629 "[t]he FCC was directed to take steps to make converter boxes (and other navigation devices) commercially available from sources other than cable operators.").

[29] *See* n. 23, *supra*.

[30] As NCTA has previously noted, the industry's willingness to support the Retail Set-Top Box Initiative reflects the fact that cable operator concerns with respect to the security risks associated with allowing retail distribution of integrated devices have been significantly reduced. *See, e.g.*, NCTA Retail Sale Comments at 39, n.93. The concerns raised by the cable industry in the initial rulemaking with respect to the provision of integrated devices at retail related in large part to the vulnerability of *analog* conditional access technology, which was then the predominant technology in the industry. With the industry's migration to *digital* conditional access technology, these concerns have been alleviated to the point where cable operators are now prepared to support the retail distribution of integrated devices. Indeed, as the discussion above indicates, the embedded security approach utilized in integrated digital set-top boxes is in fact *more secure* than the separated security approach reflected in the POD-Host Combination. *See* discussion at 2, n.3, *supra*, and sources cited therein.

to develop and evolve OpenCable hardware and OCAP software ("middleware") specifications in order to enhance the functionality and portability of the POD-Host option.[31] Rather, we suggest that the best public policy here is to ensure that consumers can choose *either* of these two options, depending on which best fits their particular needs and preferences. While many consumers are likely to prefer the particular features in an integrated device, which might be offered by a cable operator *or* a retailer, some may prefer the different features offered in a Host device, which also might be offered by a retailer or a cable operator.[32] In short, we wholly endorse the view previously articulated by Chairman Powell, urging that "the market should be allowed to play this out."[33]

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[31] *See, e.g.*, NCTA Retail Sale Comments at 2-3, 20-21; NCTA Retail Sale Reply Comments at 2, 15; NCTA Response to CERC at 9-13, 18-19; MSO Commitment Letters, *supra* n.22.

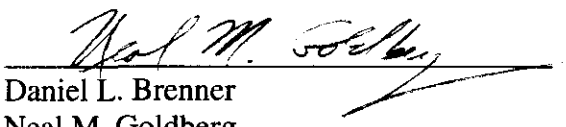
[32] Indeed, retailers seeking to market Host devices have product integration opportunities of their own that may create efficiencies, in the form of reduced cost and/or increased functionality for products integrating navigation device functions into other consumer electronics equipment (*e.g.*, TV, DVDs, VCRs), which may make such products appealing to consumers. *See* NCTA Retail Sale Comments at 32-33; NCTA Retail Sale Reply Comments at 42-43; NCTA Response To CERC at 21-22.

[33] Statement of Commissioner Powell, *Report and Order*, 13 FCC Rcd. at 14848. *See also Implementation of Section 17 of the Cable Television Consumer Protection and Competition Act of 1992: Compatibility Between Cable Systems and Consumer Electronics Equipment*, Memorandum Opinion and Order, 11 FCC Rcd. 4121, ¶ 38 (1996) (holding that it is in the public interest to permit cable operators to continue to provide integrated devices in an environment where non-security devices are available at retail).

CONCLUSION

Based on the foregoing, particularly the new cost data described herein, and in light of the fact that the Commission's prior rationale for the integration ban no longer exists due to changed circumstances, NCTA respectfully urges the Commission to eliminate the integration ban.

Respectfully submitted,



Daniel L. Brenner
Neal M. Goldberg
Loretta P. Polk

Counsel for the National Cable &
Telecommunications Association
1724 Massachusetts Avenue, N.W.
Washington, D.C. 20036
(202) 775-3664

William A. Check, Ph.D.
Vice President, Science &
Technology

Andy Scott
Director of Engineering

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